

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SAN JOSE WATER COMPANY (U-168-W) to borrow funds under the Safe Drinking Water State Revolving Fund and to add a surcharge to water rates to repay the principal and interest on such loan.

Application 03-02-010
(Filed February 4, 2003;
Petition for Modification
Filed May 14, 2004)

OPINION MODIFYING DECISION 03-07-013**I. Summary**

This order modifies Decision (D.) 03-07-013 by permitting San Jose Water Company (SJW) to issue a letter of credit in lieu of a security interest in its assets to the Department of Water Resources (DWR) to support a \$2,474,000 Safe Drinking Water State Revolving Fund (SDWSRF) loan contract with DWR.

II. Background

SJW designed and constructed off-spec water diversion facilities (Project No. 4310011-07) to recover and store high turbidity water¹ that cannot be treated quickly enough to meet California's Interim Enhanced Surface Water Treatment Rule (IESWTR) at its Montevina Water Treatment Plant (Montevina plant).

D.03-07-013 authorized SJW to enter into a SDWSRF loan to finance the design and construction of its off-spec water diversion project and to grant a

¹ Turbidity is a measure of the cloudiness of water. It is used to indicate water quality and filtration effectiveness. Higher turbidity levels are often associated with higher levels of disease-causing microorganisms such as viruses, parasites and some bacteria.

security interest in its assets as collateral to the loan. SDWSRF loans are low interest loans provided in part from a Federal Capitalization Grant for Drinking Water State Revolving Fund. Pending approval of the project and the loan respectively from the Department of Health Services and DWR,² SJW advanced the funds from existing capital to begin the project. This project is not included in SJW's current rates, the costs of which are being finalized.

III. Discussion

On May 14, 2004, SJW filed a petition to modify Ordering Paragraph 1 of D.03-07-013 so that it may issue a \$1.25 million (50% of the loan amount) stand-by letter of credit in lieu of a security interest in its assets. SJW seeks this modification because DWR requires SJW to secure the SDWSRF loan with a security instrument and SJW's Senior Note Agreements prohibit any of SJW's creditors from attaching liens to SJW's property or assets without making effective provision securing all the Senior Notes outstanding. The securing of its Senior Notes would present an undue burden to SJW.

Pub. Util. Code § 823(d) states that no note payable at a period of not more than 12 months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the commission.

² DHS is responsible for determining whether the proposed project meets water quality standards and whether it should be funded (using pre-adopted criteria). DWR is responsible for assessing the utility's financial need to meet the water quality standards and ability to meet the loan obligations. DWR also acts as the lending agency and fiscal administrator of the loan.

Because the letter of credit will be renewed every year upon the anniversary of the contract execution, it is necessary that we authorize the letter of credit arrangement pursuant to Pub. Util. Code § 823(d). The combined terms of the original letter of credit and the yearly renewal will exceed 12 months. This credit facility will take over, discharge, or retire in part, SJW's liability to DWR. There are no proceeds to SJW in this arrangement.

Pub. Util. Code § 1904(b) states that no fee need be paid on such portion of any such issue as may be used to guarantee, take over, refund, discharge, or retire any stock, bond, note or other evidence of indebtedness on which a fee has theretofore been paid to the commission.

On July 17, 2003, SJW paid \$3,474, the fee required by Pub. Util. Code § 1904(b) for the \$2,474,000 loan authority granted in D.03-07-013. Because the proposed letter of credit will be used to guarantee or take over SJW's existing debt for which a fee has already been paid, the Pub. Util. Code § 1904(b) exemption applies to the authority we are granting in this order modifying D.03-07-013. Accordingly, no fee will be assessed.

We will grant the authority requested in the petition. The substitution of a letter of credit for a security interest in SJW's assets accomplishes the same end result without unduly burdening SJW or its ratepayers. There is no opposition to this request. It is in the ratepayers' interest to grant the requested modification of D.03-07-013.

D.03-07-013 also granted SJW authority to establish a customer surcharge to repay the \$2,474,000 loan principal and interest over a 20-year period. Consistent with the approval of SDWSRF loans to other water companies, we clarify the conditions that apply to the imposition of surcharges used to repay such loans. The conditions governing the establishment of a customer surcharge

authorized by Ordering Paragraph 4 of D.03-07-013 (*mimeo*) and discussed on pages 5 and 6 of that decision should be clarified to state that the utility plant financed through the customer surcharge should be permanently excluded from rate base for ratemaking purposes and that the depreciation on this plant should be recorded in memorandum accounts for income tax purposes only.

IV. Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

V. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Michael J. Galvin is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SJW applied for a SDWSRF loan to finance its off-spec water diversion project.
2. SJW advanced the funds necessary to construct an off-spec water diversion at its Montevina plant from its existing capital so that it could avoid shutting down the plant during the periods of time it exceeded the NTU standard.
3. The Montevina plant off-spec project cost is not included in rates.
4. DWR requires SJW to provide a security instrument that supports the SDWSRF loan.
5. SJW's Senior Note Agreements prohibit any of SJW's creditors from attaching liens to SJW's property or assets without making effective provision securing all Senior Notes outstanding.
6. The securing of all Senior Notes outstanding would present an undue burden on SJW.

7. On July 17, 2003, SJW paid the fee for the authority granted by D.03-07-013 as required by Pub. Util. Code § 1904(b).

8. The utility plant financed by the loan authorized by D.03-07-013 should be permanently excluded from rate base for ratemaking purposes.

9. There are no filed protests to this application.

Conclusions of Law

1. The petition should be granted to the extent addressed in the body of this order.

2. Refunding of short-term debt should comply with the provisions of Pub. Util. Code § 823(d).

3. Pursuant to Pub. Util. Code § 1904(b), no fee need be paid on any portion of any issue that would be used to guarantee, take over, refund, discharge, or retire any evidence of indebtedness on which a fee has been paid to the Commission.

4. Today's order should be made effective immediately so that SJC can timely enter into a SDWSRF loan with the DWR.

O R D E R

IT IS ORDERED that:

1. Decision (D.) 03-07-013 shall be modified, as shown in Appendix A, to permit San Jose Water Company (SJW) to provide the California Department of Water Resources (DWR) a security instrument such as a letter of credit to support SJW's loan with the DWR for capital expenditures within its Service Area.

Ordering Paragraph 1 of D.03-07-013 shall be modified to read as follows:

"1. San Jose Water Company (SJW) is authorized pursuant to Section 816, et seq. of the Public Utilities Code, to issue evidence of indebtedness in an

amount not to exceed \$2,474,000 and to grant a security interest in its assets or any other security instrument, such as a letter of credit that supports the loan, agreeable to DWR for capital expenditures within its Service Area. A copy of the promissory note and loan contract agreement shall be filed with the Water Division within 15 days after execution.”

2. D.03-07-013 shall be amended to clarify the terms of the customer surcharge; Ordering Paragraph 4 of D.03-07-013 is amended, as shown in Appendix A, to read as follows:

“4. SJW is authorized to file an Advice Letter imposing a surcharge on its customers to repay the indebtedness authorized in Paragraph 1 of this order. The plant paid for by the surcharge shall be permanently excluded from rate base for ratemaking purposes.”

3. Application 03-02-010 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A

DECISION 03-07-013 as MODIFIED BY DECISION 04-

O R D E R

IT IS ORDERED that:

1. San Jose Water Company (SJW) is authorized pursuant to Section 816, et seq. of the Public Utilities Code, to issue evidence of indebtedness in an amount not to exceed \$2,474,000 and to grant a security interest in its assets or any other security instrument, such as a letter of credit that supports the loan, agreeable to DWR for capital expenditures within its Service Area. A copy of the promissory note and loan contract agreement shall be filed with the Water Division within 15 days after execution.

2. SJW shall retain all invoices related to the Montevina plant off-spec water diversion project financed by the Safe Drinking Water State Revolving Fund loan so that Commission staff may confirm that the loan was properly used for the stated purpose and reimbursable through a customer surcharge.

3. SJW shall maintain adequate records to enable Commission staff to audit the reasonableness of the surcharge, revenues collected through the surcharge, and payments of principal and interest on the loan.

4. SJW is authorized to file an Advice Letter imposing a surcharge on its customers to repay the indebtedness authorized in Paragraph 1 of this order. The plant paid for by the surcharge shall be permanently excluded from rate base for ratemaking purposes.

5. On or before July 31, 2004, and yearly thereafter, for as long as the surcharge is imposed, SJW shall send a comparative report to the Water Division stating the changes in the number of connections by type of customer and by size of connection, the amount of surcharge collected, the amount of repayments made, the outstanding balance of the loan, and the overages and shortages in SJW's balancing account. SJW shall also indicate in the report if an advice letter will be forthcoming to reflect changes in the rate surcharges.

6. SJW shall pay a \$3,474 fee as required by Section 1904(b) of the Public Utilities Code.¹

7. Application 03-02-010 is closed.

This order is effective today.

Dated July 10, 2003, at San Francisco, California.

(END OF APPENDIX A)

¹ The amount subject to the fee is \$2,474,000. The fee is determined as follows: (\$2 times (1,000,000/1,000)) plus (\$1 times \$1,474,000) equals \$3,474.